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HIGH COURT DECISION ON BENEFICIAL OWNERSHIP REGARDING DIVIDENDS FROM DANISH TARGET COMPANIES

It has long been common practice for foreign companies to acquire Danish companies through a controlled holding company in countries such as Luxembourg. This has led the Danish Tax and Customs Administration ("SKAT") to commence a number of proceedings, arguing that the Danish target company is required to withhold taxes on interests and dividends made to the foreign holding company. The idea is that the controlled holding company is not considered the beneficial owner of the payments in question and thus, the payments are subject to Danish taxation.

The first cases addressing this precise issue have been highly anticipated. The Danish Eastern High Court has now made a decision regarding the withholding in connection with a Danish company's payments in such a private equity fund structure. The High Court concluded that the foreign parent (Luxembourg S.a.r.l.) was the beneficial owner of the payments. Thus, no withholding requirement applied to the payments from the Danish company.

Initially, The Danish National Tax Tribunal had decided in favour of the private equity fund stating that taxes should not be withheld on dividends. However, the Danish Ministry of Taxation brought the decision before the City Court claiming that taxes should be withheld. The City Court referred the case to the Eastern High Court due to its character of general public importance.

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Facts

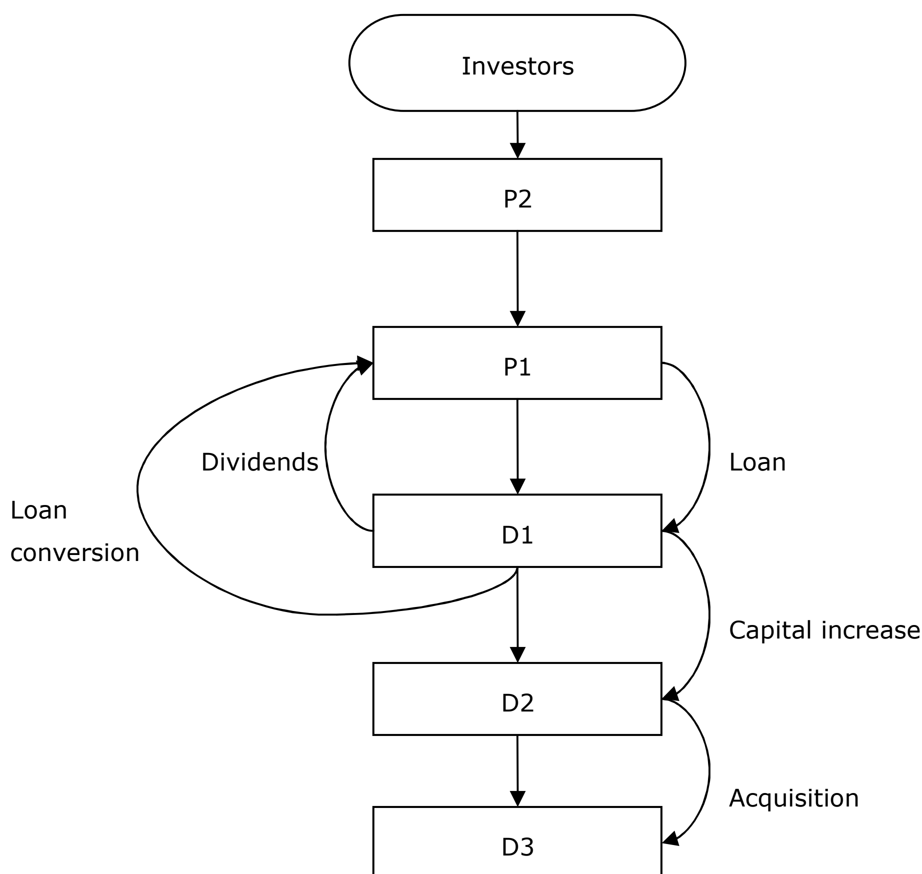
A Danish company, D1, paid dividends to its foreign parent, P1. Subsequently, the parent, P1, lent a larger part of the dividends back to the Danish company, D1. Concur-

rently, D1 affected a capital increase in one of its Danish subsidiaries, D2, by contributing the money borrowed from P1. D2 then used that money to acquire D3, a third Danish company. At the conclusion of the accounting year, the loan from P1 to D1 was converted into D1 stock.

P1 was structurally a subsidiary of another foreign parent, P2, which was ultimately owned by a number of investors.

The issue was a matter of whether P1 was a mere conduit, whose sole purpose was to avoid withholding, or whether it was the beneficial owner of the money received from the Danish company.

The company structure and the relevant cash flow may generally be illustrated as follows:



The Legal Basis

Danish companies are required to withhold taxes when deciding to pay out dividends to foreign shareholders. One exception to this rule is that withholding is not required if a

foreign company receives dividends from a Danish company and the dividends are not subject to taxation under the Danish Companies Tax Act.

Pursuant to the Danish Companies Tax Act effective at the time, foreign companies are generally subject to taxation, with the exception of companies which own at least 20% of the share capital in the dividends-paying company for a concurrent period of at least one year. All of this is conditional upon the taxation being decreased or eliminated according to the EU's parent/subsidiary Directive, or the applicable tax treaty.

The High Court's Decision

Initially, the High Court noted that, as a starting point, a holding company which receives dividends from its subsidiary is the rightful owner of such dividends. This also applies in cases where the intermediary holding company to which the payments are made, which is located in a state with which Denmark has no double taxation agreement, is added to the company structure. This applies even if the ultimate owner of the holding company is located in a state with which Denmark has no double taxation agreement.

The determinative factor as to whether the entity in question is a mere conduit is whether it only enjoys very limited powers which, regardless of its formal ownership, acts on the behalf of others. The High Court emphasized, however, that having limited powers does not, in and of itself, provide a sufficient basis to conclude that the entity in question is a mere conduit. Correspondingly, it is required that more than regular planning and control is performed at group level than what is normal in international groups in order for the controlled company not to be the beneficial owner.

Subsequently, the High Court concluded that it was unnecessary to make a decision concerning which kind of control the parent was exercising over P1, as P1 did not forward the dividends received to its parent, but instead used the funds to provide D1 with a loan to the company which paid the dividends. Therefore, P1 could not be viewed as being a mere conduit. Therefore, the High Court found that P1 was the beneficial owner of the dividends, and no withholding therefore requirement applied.

The Decision's Consequences

With the decision of the High Court, we have come closer to a clarification as to the withholding requirement regarding cross-border payments of dividends, interests and royalties. However, not until an anticipated final decision from the Supreme Court on the matter has been given will we have absolute clarification. The High Court's decision itself also raises a number of interpretation issues.

The specific outcome of the decision must be considered correct, in as much as the dividends were not forwarded to the ultimate owners. The term “conduit” makes little sense if no money actually runs through it. One may wonder then, why the Danish Tax and Customs Administration (“SKAT”) chose this case to be the first to be presented to the courts.

The High Court notes that limited powers are a requisite for finding that the entity is a conduit which in relation to the dividends makes it a nullity or administrator. Concurrently, it is noted that limited powers, in and of itself, is an insufficient basis to conclude that the entity is not the beneficial owner. Thus, something more is required. Therefore, the decision does not disqualify regular holding companies from being beneficial owners.

With this statement, it is far from given that the tax authorities will reach the opposite conclusion than the one in the case at bar in circumstances where the entity is in fact a mere conduit.

Evidently, the High Court supports a *dynamic interpretation* of the tax treaties, in that it refers to OECD’s commentary to Article 10 of the 2003 treaty, even though the case involved the interpretation of a treaty from 1980. Moreover, by referring to the OECD commentary, the High Court seems to support the notion that the term beneficial owner is to be interpreted autonomously.

It remains unclear what relevance the decision has for payments other than dividends, such as interests and royalties. The decision’s central message that the forwarding of the payments is a requisite should, however, apply equally to these types of payments for the exact same reasons.

Regardless of the fact that the decision deals with atypical circumstances in relation to the classic beneficial owner situations, the decision may be relevant for the private equity sector, in that it is common practice in this sector, that dividends (or interests) are not forwarded to the ultimate owners, but are instead used to service bank debt in the holding company. For this reason, the decision may prove to be of practical importance.

If the High Court’s determination is any indication as to the decisions to come, it is very probable that the legislature will enact a specific rule to address these situations.

If you have any questions or require additional information on the decision, please contact Partner, Dan Moalem (dmo@mwblaw.dk) or Junior Associate Kim David Lexner (kdl@mwblaw.dk).

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